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POLICY & LAW | US & WORLD | BITCOIN

75

This week's Bitcoin crash was all about fraud and regulation

By Simon Chandler | Jan 18, 2018, 9:35am EST

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Cryptocurrencies have had a rough week: the value of bitcoin plunged to a mere 50 percent of its 2017 peak, and other currencies, such as Ethereum, Ripple, and Litecoin have seen double-digit losses compared to their heights from last year. Tuesday also witnessed the collapse of BitConnect, an anonymously operated crypto exchange that had been repeatedly accused of running a Ponzi scheme via its proprietary BCC currency.

Taken together, these events may simply act as another reminder of the "volatility" of the cryptocurrency market, which saw bitcoin rise to a peak of $19,783 on December 17th. Bitcoin has gone through multiple crashes before: in spring 2011, in November 2013, and in January 2017. However, this current bubble comes against a new backdrop: a global tide of regulation against the inchoate cryptocurrency industry. On one hand, these regulations may be scaring bitcoin investors into selling their coins now before the full impact of regulation makes itself felt. On the other, it may also be threatening suspect exchanges such as BitConnect, with its own token declining in value by 46 percent between December 17th and January 15th — the day before it announced its closure.

THE VALUE OF BITCOIN PLUNGED TO A MERE 50 PERCENT OF ITS 2017 PEAK

In the United States, regulation has reared its head in the form of the SEC. Last month, its newly formed Cyber Unit pressed charges for the first time against PlexCorps, which was accused of defrauding investors through a questionable initial coin offering, or ICO. Almost a week later, SEC chairman Jay Clayton issued a warning on cryptocurrencies to investors, hinting that the commission would begin monitoring the market more closely for any potential violations of securities laws. The US isn't the only nation taking a harder line on cryptocurrencies, either: the Chinese government tightened its ban on crypto trading this week, and the South Korean government is planning on implementing a similar ban itself.

This global movement toward harsher regulation has been cited as a major cause of the exodus of value that has gripped cryptocurrencies in the past week. It would also potentially account for BitConnect's collapse, which came after multiple cease and desist letters from securities watchdogs in Texas and North Carolina.

A historic lack of regulation likely contributed to the current bitcoin bubble by facilitating market manipulation and duplicitous trading practices. Even as bitcoin became a household name in 2017, such practices remained common. In November, a *Business Insider* investigation discovered that "pump and dump" scams — where investor groups artificially inflate cryptocurrency values by orchestrating mass purchases of coins — were "rife" on the US exchange Bittrex. Similarly, Bitfinex, the biggest exchange by daily volume, acknowledged market manipulation on its platform in August, when it revealed that it had detected several accounts engaging in "large-scale manipulation tactics" relating to the Bitcoin Cash currency.

SUCH MANIPULATIVE ACTIVITY COULD BE THE TIP OF THE ICEBERG

Such manipulative activity could be the tip of the iceberg, given that certain critics have even accused Bitfinex of creating Tether, a cryptocurrency pegged to the US dollar, in order to buy bitcoins and artificially inflate the latter's value. What's clear is that such disreputable methods as "pump and dump" and "spoofing" are possible because exchanges like Bitfinex are unregulated. In any regulated market, the action of traders such as the infamous "Spoofy" would be illegal. Yet, without the active oversight of the SEC or FINRA, they can be carried in the cryptocurrency market with impunity.

Because market manipulation has helped push cryptocurrencies to dizzy, grossly inflated heights, the recent falls in value have been similarly spectacular. But unlike with previous drops, the newly emerging drive to regulate the cryptocurrency market could hobble a recovery. Assuming that the likes of the SEC and FINRA begin clamping down on fraudulent trading practices, and assuming that these practices were vital to Bitcoin's precipitous rise, then Bitcoin may very well struggle to climb as quickly in 2018 as it did in 2017. Not only will the parties responsible for manipulative trading be inclined to sell their ill-gotten gains and run, but an increasing number of people will fully realize that the cryptocurrency market is a hive of dubious activity. That said, if greater regulation tamps down disreputable practices and brings the cryptocurrency into the regulatory mainstream, the longer-term trend may only be upward.